POSCO (PKX)

Updated July 20th, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	$98	**5 Year CAGR Estimate:**	1.2%	**Market Cap:**	$33 B
Fair Value Price:	$120	**5 Year Growth Estimate:**	-10.0%	**Ex-Dividend Date:**	09/29/2023[1]
% Fair Value:	82%	**5 Year Valuation Multiple Estimate:**	4.1%	**Dividend Payment Date:**	12/02/2023
Dividend Yield:	9.2%[2]	**5 Year Price Target**	$71	**Years Of Dividend Growth:**	N/A
Dividend Risk Score:	D	**Retirement Suitability Score:**	B	**Rating:**	Sell

Overview & Current Events

POSCO – formerly called Pohang Iron & Steel – is the third-largest producer of steel and related products in the world. The company – headquartered in Seoul, South Korea – produced about 34 million tons of steel in the most recent fiscal year. Investors can initiate an ownership stake in POSCO through American Depository Receipts that trade on the New York Stock exchange under the ticker PKX with a market capitalization of $30.7 billion. POSCO reports results in Korean Won, but all figures listed in U.S. Dollars throughout this report.

POSCO reported its Q2 earnings on July 18th, 2023, with results coming in mixed. For the quarter, revenue fell 12.6% to $15.7 billion. Operating profit fell by roughly 38% to $1 billion. The company's performance was negatively impacted by price drops in key products as well as one-off losses from flood damage at its Pohang, South Korea plant following a typhoon in September.

China's GDP growth disappointed market expectations in the second quarter, and property investment for the first half of the year sank by nearly 8%, deepening concerns about low resource demand in the world's top steel consumer. Along with elevated geopolitical risks, the steel market is a tougher one to navigate this year versus fiscal 2022.

However, with steal prices somewhat recovering in June, we remain cautiously optimistic about POSCO's performance in the second half of the year.

We forecast FY-2023 EPS of $30.00. The company has also updated its dividend policy, expecting to maintain a 30% payout ratio in 2023. Hence, we forecast a DPS of around $7.50 this year.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	$16.42	$6.88	$1.57	$13.78	$32.30	$18.78	$19.75	$18.54	$73.35	$37.12	***$30.00***	***$17.71***
DPS	$7.58	$7.33	$6.80	$6.63	$7.50	---	---	---	$14.28	$9.42	***$9.00***	***$5.31***
Shares[3]	78.0	79.8	80.0	80.0	80.0	80.0	80.1	79.1	76.7	75.6	***75.6***	***72.0***

POSCO's earnings-per-share history demonstrates the company's dependence on steel prices. The company's earnings-per-share declined from $16.42 in fiscal 2013 to a $6.88 deficit in fiscal 2015. Management sees new growth opportunities ahead, such as environment-friendly vehicles, energy, and mega-city industries, which could help drive some earnings growth over time.

Further, the current demand and margins have turned in POSCO's favor as of lately. However, we are cautious about steel's future global demand and price due to its cyclical nature. As a result, we estimate a decline of 10% annually in EPS, assuming both steel prices and demand gradually retreat from their current levels.

Future profitability risks remain, as commodity prices are highly unpredictable and are expected to fluctuate significantly in times of uncertainty, and special circumstances, such as last year's supply shortages.

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[1] Estimated dates based on past dividend dates

[2] Based on speculative, estimated DPS of $9.60 for FY-2023.

[3] Share count in millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	18.1	---	---	13.8	8.3	13.6	10.7	13.8	3.1	1.4	***3.3***	***4.0***
Avg. Yld.	2.4%	2.6%	3.7%	3.7%	3.4%	---	---	---	2.6%	17.7%	***9.2%***	***7.5%***

POSCO's average price-to-earnings ratio over the past decade has been around 10, excluding the years 2014 and 2015, in which the valuation metric was not meaningful due to depressed earnings. We have assigned a fair value at 4.0 times earnings in the medium-term, due to POSCO's current, inflated results.

Income investors should note that the South Korean government applies a 22% withholding tax on dividends paid to international investors.

Safety, Quality, Competitive Advantage, & Recession Resiliency

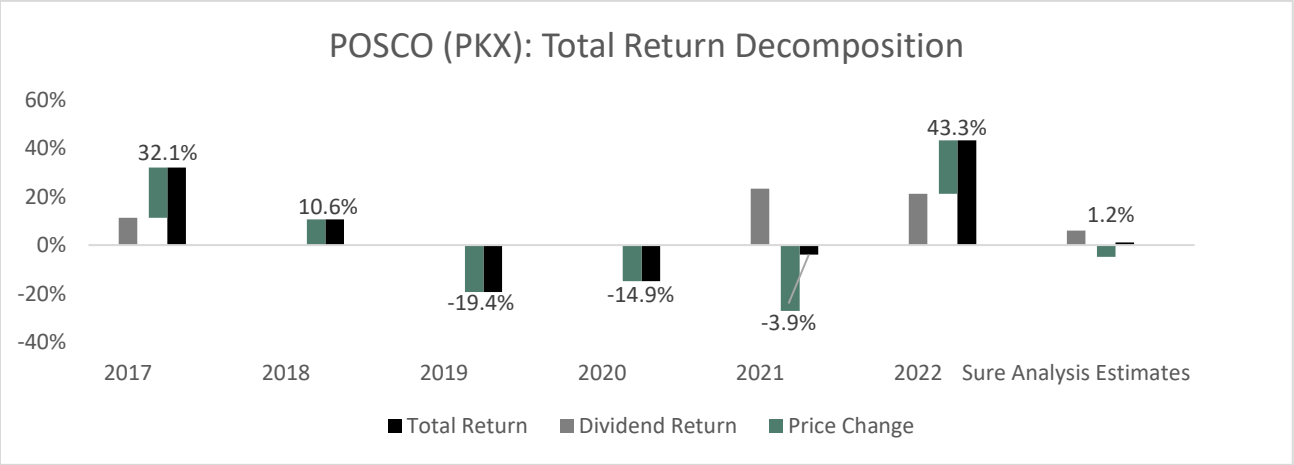
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	46%	107%	433%	48%	23%	---	---	---	19%	25%	***30%***	***30%***

Based on Posco's updated dividend policy including maintaining payout ratio of around 30%, management is more than likely to continue preserving robust liquidity amid any unfavorable price levels of steel in the future. Based on the uncertainties surrounding the sector, the future net income and dividends remain highly speculative, nonetheless. Thankfully, while competitive advantages are tough to come by for steel manufacturers, POSCO has a huge global presence in steel production as one of the largest such companies in the world. This affords it a brand presence and scale that smaller competitors cannot match. Recessions are obviously a huge negative shock to steel producers as demand for all kinds of products declines during downturns. Therefore, POSCO will likely suffer considerably during such an environment nonetheless.

Final Thoughts & Recommendation

POSCO appears priced to deliver uninspiring returns in the coming years. Last year was an excellent trading period, but we expect tailwinds in the steel industry to fade away. We believe the stock makes for a good vehicle for investors seeking exposure to steel, but the stock is not a reliable long-term investment in our opinion. We rate POSCO a sell based on our 1.2% annualized projected returns and also note that a myriad of factors could affect the stock in the coming years. Combined with risks attached to Korean corporate governance, the stock's investment case is highly speculative.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	61437	51682	45561	53246	58952	59112	48750	66410	66050
Gross Profit	6919	5744	5739	7317	7233	7281	3981	10360	5969
Gross Margin	11.3%	11.1%	12.6%	13.7%	12.3%	12.3%	8.2%	15.6%	9.0%
SG&A Exp.	3034	2821	2589	2562	1593	1593	1954	1866	1737
D&A Exp.	3072	2842	2766	2917	2965	2965	3055	3127	2870
Operating Profit	2759	2017	2502	4266	5013	5061	2028	8140	3811
Op. Margin	4.5%	3.9%	5.5%	8.0%	8.5%	8.6%	4.2%	12.3%	5.8%
Net Profit	600	151	1166	2438	1534	1553	1351	5772	2453
Net Margin	1.0%	0.3%	2.6%	4.6%	2.6%	2.6%	2.8%	8.7%	3.7%
Free Cash Flow	-415	4197	2416	2633	2982	2982	4376	2401	595
Income Tax	782	235	327	1049	1516	1527	200	1934	359

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	78203	68474	66354	74679	69954	70427	72520	77530	78430
Cash & Equivalents	3472	4130	2027	2445	2364	2364	4360	4011	6378
Acc. Receivable	9852	7591	7718	8031	8593	7732	7447	7784	6378
Inventories	10179	7265	7879	10103	10281	10865	8300	13520	12780
Goodwill & Int.	6188	5304	4907	5379	4451	4451	4080	3448	3690
Total Liabilities	36974	30303	28460	30382	28151	28701	28810	31570	32340
Accounts Payable	4503	3301	4227	3976	4215	4282	3444	5463	5500
Long-Term Debt	24987	21387	18800	19716	18067	18067	18800	18260	19250
Total Equity	37858	34942	35053	40866	38774	38732	40650	42320	41560
LTD/E Ratio	0.66	0.61	0.54	0.48	0.47	0.47	0.46	0.43	0.46

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	0.8%	0.2%	1.7%	3.5%	2.1%	2.1%	1.9%	7.7%	3.2%
Return on Equity	1.5%	0.4%	3.3%	6.4%	3.9%	3.9%	3.4%	13.9%	5.9%
ROIC	0.9%	0.2%	2.0%	4.0%	2.5%	2.5%	2.2%	9.1%	3.8%
Shares Out.	320	320	320	320	320	320	318	307	315.63
Revenue/Share	192.47	161.52	142.39	166.40	184.22	184.72	153.38	216.48	209.26
FCF/Share	-1.30	13.12	7.55	8.23	9.32	9.32	13.77	7.83	1.89

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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